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IN THE  
**Supreme Court of the United States**

OCTOBER TERM, 1983

SECURITIES INDUSTRY ASSOCIATION,

*Petitioner,*

v.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, *et al.*,

*Respondents.*

ON WRIT OF CERTIORARI TO THE  
UNITED STATES COURT OF APPEALS  
FOR THE SECOND CIRCUIT

**BRIEF OF THE AMERICAN BANKERS ASSOCIATION, THE NEW  
YORK CLEARING HOUSE ASSOCIATION, THE CALIFORNIA  
BANKERS CLEARING HOUSE ASSOCIATION, UNION PLANTERS  
NATIONAL BANK AND SECURITY PACIFIC NATIONAL BANK AS  
AMICI CURIAE**

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**BRIEF OF THE AMERICAN BANKERS ASSOCIATION,  
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CIATION, UNION PLANTERS NATIONAL BANK AND  
SECURITY PACIFIC NATIONAL BANK AS AMICI  
CURIAE**

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**INTEREST OF AMICI CURIAE**

The American Bankers Association is the national organi-  
zation of banking, numbering within its membership some

13,600 commercial banks or approximately 91 percent of all such banks in the United States. The New York Clearing House Association (the "Clearing House") is an association of 12 leading commercial banks located in New York City.<sup>1</sup> It operates electronic payment systems and clears commercial drafts and items in the New York area. The Clearing House appeared as amicus curiae before the Court of Appeals for the Second Circuit in this action, *Securities Industry Association v. Board of Governors of the Federal Reserve System*, 716 F.2d 92 (2d Cir. 1983), cert. granted, 52 U.S.L.W. 3550 (Jan. 23, 1984). The California Bankers Clearing House Association (the "California Clearing House") is an association of ten major commercial banks that are located in California.<sup>2</sup> It clears commercial drafts and items in that state. Union Planters National Bank and Security Pacific National Bank are national banking associations located in Tennessee and California respectively. We submit this brief in support of respondents, urging affirmance of the decision below.

All parties to this brief have a direct and vital interest in the proper interpretation of Federal banking statutes such as the Glass-Steagall Act and the Bank Holding Company Act. We believe that the Court of Appeals correctly interpreted the Glass-Steagall Act to find that commercial banks and their affiliates may conduct a securities brokerage business, and correctly held that the Board properly exercised its authority under the Bank Holding Company Act in permitting Bank-

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<sup>1</sup> The members of the Clearing House are The Bank of New York, The Chase Manhattan Bank, N.A., Citibank, N.A., Chemical Bank, Morgan Guaranty Trust Company of New York, Manufacturers Hanover Trust Company, Irving Trust Company, Bankers Trust Company, Marine Midland Bank, N.A., United States Trust Company of New York, National Westminster Bank USA and European American Bank & Trust Company.

<sup>2</sup> The members of the California Clearing House are Bank of America, N.T. & S.A., California Canadian Bank, City National Bank, Crocker National Bank, First Interstate Bank of California, Lloyds Bank of California, Security Pacific National Bank, The Bank of California, N.A., Union Bank and Wells Fargo Bank, N.A.

America Corporation ("BAC"), a bank holding company and parent of Bank of America, N.T. & S.A., to acquire Charles Schwab & Co., Inc. ("Schwab"), a discount securities broker. We further believe that the views presented in this brief will significantly aid the Court in its consideration of the issues raised by this action.

## INTRODUCTION AND SUMMARY OF ARGUMENT

The Securities Industry Association (SIA) seeks to invoke the Glass-Steagall Act, Pub. L. No. 66, 48 Stat. 162 (1933), and the Bank Holding Company Act, 12 U.S.C. §§ 1841 *et seq.*, to protect its members from the enhanced competition resulting from the acquisition of a discount brokerage firm by a bank holding company. As we show below, however, neither statute was designed to shelter the securities industry from competition or to preclude bank holding companies from engaging in the brokerage business. On the contrary, § 16 of the Glass-Steagall Act, 12 U.S.C. § 24 (Seventh) (1982), expressly authorizes commercial banks to purchase and sell securities upon the order and for the account of customers. This explicit statutory authority and the long-standing practice of banks in providing brokerage services also demonstrate that brokerage activities are "so closely related to banking . . . as to be a proper incident thereto" within the meaning of § 4(c)(8) of the Bank Holding Company Act, 12 U.S.C. § 1843(c)(8) (1982).

## ARGUMENT

### I

#### THE GLASS-STEAGALL ACT AUTHORIZES COMMERCIAL BANKS TO CONDUCT A BROKERAGE BUSINESS.

A principal objective of the Banking Act of 1933, Pub. L. No. 66, 48 Stat. 162 (1933), commonly known as the Glass-Steagall Act, was to separate certain aspects of the business of investment banking, specifically the underwriting of certain

securities issues, from the business of commercial banking. *Board of Governors of the Federal Reserve System v. Investment Company Institute*, 450 U.S. 46 (1981). To that end, §§ 16 and 21 of the Act, 12 U.S.C. §§ 24 (Seventh), 378 (1982), restrict the power of commercial banks to underwrite certain securities, while § 20 of the Act, *id.* § 377, prohibits affiliation between commercial banks and firms principally engaged in underwriting and certain related activities.

Notwithstanding these restrictions, the Glass-Steagall Act was not designed to effect a total prohibition on commercial banks' participation in securities activities or to insulate the securities industry from competition with commercial banks. On the contrary, under the Act, banks retained power to engage in a variety of securities-related activities. For example, under § 16 of the Act, banks may buy and sell "investment securities" for their own account and may underwrite government, municipal and certain other securities. 12 U.S.C. § 24 (Seventh) (1982). In addition, as we show below, § 16 of the Act expressly permits banks to conduct a brokerage business. As we also show, § 20 of the Act does not withdraw from bank affiliates the brokerage powers that § 16 explicitly confers on banks themselves.

**A. Section 16 of the Glass-Steagall Act Authorizes Commercial Banks To Conduct a Brokerage Business, and They Have Done So for Decades.**

Section 16 of the Glass-Steagall Act provides in pertinent part:

"The business of dealing in securities and stock by [a national bank] shall be limited to purchasing and selling such securities and stock without recourse, solely upon the order, and for the account of, customers, and in no case for its own account. . . ." 12 U.S.C. § 24 (Seventh) (1982).

This provision, which applies to state member banks as well as to national banks, *see* 12 U.S.C. § 335 (1982), *expressly authorizes* banks to conduct a brokerage business. "Purchasing and selling . . . securities and stock without recourse, solely upon the order, and for the account of, customers" is precisely

the business of a securities broker. A broker receives orders for securities transactions from customers and executes them on exchanges or with dealers, acting as an agent, without indemnifying its customers against investment risk or loss.<sup>3</sup> In this respect, we submit that the language of the statute is dispositive.

SIA's principal objection to this straightforward reading of the statutory language is an assertion that "no bank or bank holding company had engaged in the securities brokerage business since the passage of the Glass-Steagall Act half a century ago". SIA Br. at 4. This assertion, however, is mistaken. Banks have long engaged in brokerage and related activities, and they have in fact executed securities transactions in precisely the same manner as other brokers do.

First, it is a matter of common knowledge that banks routinely perform many of the functions performed by securities brokers. For example, banks traditionally have provided custodial and record keeping services for investors, have acted as advisers in financial and investment matters and have exercised decision-making power with respect to investments they manage. As this Court noted in *Board of Governors of the Federal Reserve System v. Investment Company Institute*, *supra*, 450 U.S. at 55, the traditional fiduciary functions of banks include managing securities portfolios of investors, an activity banks have pursued "for decades". As the Court also recognized, "[a]s executor, trustee, or managing agent of funds

<sup>3</sup> A 1936 SEC report describes the activities of a broker in terms remarkably similar to those employed in § 16, thus indicating that the statutory language would have been understood to refer to brokerage when the Act was passed. The report states:

"[A] broker employed to execute an order for the purchase or sale of securities is the agent of his customer. He does not undertake to sell to or buy from his customer but rather to negotiate a contract of purchase or sale between the customer and a third party. The transaction is solely for the account of the customer who becomes the owner of securities purchased by the broker on his behalf, is entitled to the profits realized and is liable for the losses incurred." SEC, *Report on the Feasibility and Advisability of the Complete Segregation of the Functions of Dealer and Broker*, xiv (1936) (hereinafter "*Broker/Dealer Report*").

committed to its custody, a bank regularly buys and sells securities for its customers". *Id.* (emphasis added).

Further, and contrary to SIA's assertion (SIA Br. at 9, 15), in buying and selling securities banks have not merely acted as order takers, referring investors' orders to unaffiliated brokerage firms for execution, but have in fact executed such transactions directly.<sup>4</sup> Banks have long executed orders for over-the-counter securities, *i.e.*, securities which are not listed and traded on stock exchanges, without the aid of an intervening broker. See R. Westerfield, *Banking Principles and Practice* 1021 (1921). The SEC, in a special study of the securities markets conducted in 1963, reported that many commercial banks execute orders for unlisted securities (and for those listed securities that are traded over the counter) directly with market makers. SEC, *Report of Special Study of Securities Markets*, H.R. Doc. No. 95, 88th Cong., 1st Sess., pt. 2 at 861 (1963). In a more recent study, the SEC found that "to a significant degree banks effect securities transactions without using brokers at all". SEC, *Reports on Banks Securities Activities*, 95th Cong., 1st Sess., at 422 (1977).

Although brokerage commission and exchange membership rules severely impeded the ability of banks to execute orders for listed securities<sup>5</sup>, several of the major private banks—which were organized as partnerships and were therefore

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<sup>4</sup> SIA's insistence on the employment of unaffiliated brokers as intermediaries in bank securities transactions amply demonstrates the anticompetitive thrust of this litigation. SIA does not seriously dispute that banks and their affiliates generally have the expertise to engage in securities transactions without the use of such intermediaries. In insisting on their use, SIA seeks only to protect its members' commission income through a form of featherbedding.

<sup>5</sup> In the past, rules of the stock exchanges fixed the commissions that could be charged by brokers who were exchange members, *see, e.g.*, Former NYSE Rule 383; SEC, *Report of Special Study of the Securities Markets*, H.R. Doc. No. 95, 88th Cong., 1st Sess., pt. 2 at 295 (1963), and, by forbidding exchange membership to corporations, *see* 2 L. Loss, *Securities Regulation* 1172 n. 8 (2d ed. 1961), they also effectively barred most banks from exchange membership.

Because banks were thus compelled to execute transactions in listed securities through exchange members who charged fixed com-

eligible for stock exchange membership—did in fact own seats on the exchange and executed securities transactions there directly. The most notable example is J. P. Morgan & Co. Long recognized as a premier investment banking house, the Morgan firm had also maintained a substantial commercial banking business prior to the Glass-Steagall Act. When the Act became law, the Morgan firm, like many others, found it necessary to choose between its investment banking business and its commercial banking business. Unlike most other such firms, the Morgan firm elected to continue its commercial banking business and to divest its investment banking business. Strikingly, however, the firm did not relinquish its seat on the New York Stock Exchange at the time of divestiture. Instead, it retained that seat and continued to use it for execution of securities transactions for investors' accounts. N.Y. Times, June 9, 1934, at 21, col. 3.<sup>6</sup> In so doing, the firm unquestion-

missions, they could not offer brokerage services for such securities at a favorable price, and they therefore did not aggressively promote their brokerage services.

Banks did begin to expand their brokerage operations following the deregulation of brokerage commissions, which became fully effective in 1975, *see* Securities Act Amendments of 1975, 15 U.S.C. § 78f(e)(1) (1982) ("no national security exchange may impose any schedule or fix rates of commissions . . . or other fees to be charged by its members . . ."), and they have offered an increasing variety of brokerage and related services since then. *See generally*, Clark & Saunders, *Glass-Steagall Revised: The Impact on Banks, Capital Markets, and the Small Investor*, 97 Banking L. J. 811, 829-31 (1980); Note, *A Banker's Adventures in Brokerland: Looking Through Glass-Steagall at Discount Brokerage Services*, 81 Mich. L. Rev. 1498 (1983).

<sup>6</sup> The Morgan firm ultimately relinquished its exchange membership in 1940, when it reorganized as a corporation and thus became ineligible for exchange membership under the stock exchange rules discussed above. Wall St. J., Feb. 17, 1940, at 2, col. 1.

Other private commercial banking firms which maintained stock exchange seats after the Act became law include Laidlaw & Co., A. Iselin & Co., Robert Winthrop & Co. and Brown Brothers, Harriman & Co. *See* N.Y. Times, June 16, 1934, at 21, col. 8. The Brown Brothers firm has maintained its exchange seat continuously to the present. *See* 1 *Moody's Bank and Finance Manual* 1672 (1983) (Brown Brothers "[c]onducts a general domestic and foreign banking business and acts as brokers for purchase and sale of securities").

ably relied upon § 16 of the Act—and was never challenged in that interpretation even though its continuation of its brokerage business was widely publicized at the time. *See id.*; *see also* N.Y. Times, June 1, 1934, at 1, col. 1; N.Y. Times, June 8, 1934, at 31, col. 8.

Finally, the Federal Reserve Board, in an interpretation of the Glass-Steagall Act that remains unaltered to this day, expressly authorized state-chartered member banks to continue their brokerage business while engaging in the business of commercial banking. The Board ruled that the limitations set forth in § 16 of the Glass-Steagall Act were “not to be regarded as affecting dealings in corporate stock by banks”, and concluded “there is no prohibition in the Federal statutes against State member banks buying or selling shares of corporate stock solely upon the order and for the account of customers”. 20 Fed. Res. Bull. 609 (1934).

In short, petitioner ignores the historical record of commercial bank involvement in the brokerage business. Both before and after the Act was passed, banks in fact purchased and sold securities for investors.

Against this clear statutory language and the historical record, SIA raises three additional objections. First, it asserts that restrictive interpretations placed upon § 16 of the Act by the Comptroller of the Currency in the mid-1930s limit banks' brokerage activities to certain “accommodation” services. SIA Br. at 20-31. Second, SIA argues that commercial banks conducting a brokerage business will necessarily violate the requirement of § 16 that banks purchase and sell securities “without recourse”. SIA Br. at 31-34. Third, it contends that the term “customers” as employed in § 16 refers only to persons who have a prior banking relationship with the particular bank, so that banks may not offer brokerage services to the general public. SIA Br. at 21-25, 28-30. The Court of Appeals correctly found none of these remaining arguments to be persuasive.

1. *Bank Brokerage Activities Are Not Limited to "Accommodation Services"*.

SIA argues that the Board of Governors, and this Court, are bound by a restrictive interpretation of § 16 made by the Comptroller of the Currency in the mid-1930's limiting bank brokerage activities to "accommodation services" for customers. More recently, however, the Office of the Comptroller has reconsidered these early rulings, and has found that § 16 raises no bar to a national bank seeking to establish a discount brokerage subsidiary. See *Security Pacific National Bank*, [1982-83 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 99,284 (Comptroller of Currency 1982), *aff'd in pertinent part sub nom. Securities Industry Association v. Comptroller of the Currency*, 577 F. Supp. 252 (D.D.C. 1983), *cross-appeals pending*, Nos. 84-5026 and 84-5085 (D.C. Cir. 1984). In so doing, the Comptroller determined that "the early interpretations contained restrictions not imposed by the statute", *id.*, and reflected "the great caution of banking regulations in the years immediately following the 1931-2 debacle". *Id.*, quoting Letter from Comptroller of Currency to G. Duane Vieth (June 10, 1974), [1973-78 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 96,272.

The Comptroller's rejection of the early restrictive interpretation placed on § 16 by his predecessors represents not an unprincipled about-face as SIA contends, but the culmination of a gradual reassessment of those early views. As early as 1957, the Comptroller reversed his earlier ruling to the extent of determining that banks executing orders to buy or sell securities for customers were permitted to make a profit for their services. Comptroller of the Currency, Digest of Opinions, ¶ 220A (1957); see *New York Stock Exchange, Inc. v. Smith*, 440 F. Supp. 1091, 1097 (D.D.C. 1975), *vacated as not ripe for review sub nom. New York Stock Exchange, Inc. v. Bloom*, 562 F.2d 736 (D.C. Cir. 1977), *cert. denied sub nom. New York Stock Exchange, Inc. v. Heimann*, 435 U.S. 942 (1978). Similarly, in a 1974 ruling, the Comptroller rejected the view that the purchase and sale of securities could only be performed as an "accommodation" to customers:

"This [earlier] view, like many others expressed by bank regulators, in the immediate post-depression decades, was designed to be ultra-conservative and to confine banks as narrowly as possible in their activities. However, in this regard, the office apparently went further in the direction of conservatism than did the Congress, since neither the word nor the idea of the 'accommodation' limitation appears in the statute or in any committee or floor comments."

Letter from Comptroller of Currency to G. Duane Vieth (June 10, 1974), [1973-78 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 96,272.

Reviewing courts have found the Comptroller's more recent interpretation of the Glass-Steagall Act "both reasonable and correct as a matter of law", *New York Stock Exchange, Inc. v. Smith*, *supra*, 404 F. Supp. at 1101, and fully justified by the legislative history of the Act, *Securities Industry Association v. Comptroller of the Currency*, *supra*, 577 F.Supp at 255. In this action, the Court of Appeals "agree[d] with the Comptroller that the Act's policies are not contravened by bank participation in retail brokerage" and accorded "significant weight to the Comptroller's repudiation of his earlier rulings". *Securities Industry Association v. Board of Governors of the Federal Reserve System*, *supra*, 716 F.2d at 99. We submit that, as the courts have recognized, a ruling made some fifty years ago and long since rejected provides no basis to disregard the well-reasoned views of the Comptroller as presently expressed.

## 2. The Meaning of "Without Recourse".

SIA asserts that the "without recourse" limitation contained in § 16, as interpreted by this Court in *Awotin v. Atlas Exchange National Bank*, 295 U.S. 209 (1935), prevents banks from acting as brokers. Specifically, SIA asserts that the "risk [of] liability to third-party purchasers or sellers" arising in brokerage transactions constitutes a form of "recourse" prohibited by the statute as interpreted in *Awotin*. SIA Br. at 32. This contention is without merit.

First, the risk of incidental liability to third parties in the case of customer default is simply not the sort of risk with which the "without recourse" limitation is concerned. In *Awotin*, this Court held that that limitation prohibits banks from assuming the "contingent liability" that could arise under a "contract by which the bank assumes *the risk of loss which would otherwise fall on the buyer of securities*". *Awotin v. Atlas Exchange National Bank*, *supra*, 295 U.S. at 211-12 (emphasis added). As this Court made perfectly plain, the "risk" at which the limitation is aimed is the *investment risk* associated with the purchase of securities. In other words, under the "without recourse" limitation, banks cannot undertake to indemnify investors against the risk of loss associated with the investments they have made. The risk that the customer may default on the transaction is entirely different from the investment risk associated with a given security, and is thus completely irrelevant to the "without recourse" limitation.

Second, SIA's argument simply falls of its own weight. As a broker must look to his customer for payment in the event of default, so an intervening broker employed by a bank to execute transactions would look to the *bank* for payment in the event of default—and the bank, as agent for an undisclosed principal (its customer), would be liable for the transaction. See Restatement (Second) of Agency §§ 321, 322 (1958). Employment of an intervening broker merely moves the bank one additional step away from the party on the other side of the transaction—but it does not affect the risk that the bank will be held liable for its customer's default. Accordingly, if the incidental risk of liability to third parties arising from customer default were the sort of risk with which the "without recourse" limitation were concerned, then banks could *never* become involved in securities transactions even to the extent of forwarding orders to brokers for execution, for the broker would always have such "recourse" against the bank as its customer's agent. As a matter of statutory construction and common sense, the "without recourse" limitation cannot have been intended by Congress to swallow up authority otherwise granted by the statute

Finally, since the day the Glass-Steagall Act was passed, banks have consistently assumed the risk associated with customer default. As discussed above, since the enactment of the statute, banks have executed securities transactions both with and without the aid of intervening brokers. In each and every such transaction, the bank serving as broker has assumed, of necessity, the risk which SIA views with such alarm. So far as we are aware, it has never been suggested that the necessary assumption of that risk violates the Glass-Steagall Act. On the contrary, since 1934, federal banking regulators have implicitly approved banks' assumption of that risk by their endorsement of commercial bank brokerage activity. See, e.g., 20 Fed. Res. Bull. 609 (1934). Banks have assumed that risk—and have been permitted by banking authorities to do so—for the simple reason that the statute is concerned only with assumption of investment risk, and has nothing whatever to do with the risk of customer default incidental to any securities transaction.

### 3. *The Meaning of "Customers".*

SIA suggests that the term "customers" as employed in § 16 permits a bank to offer brokerage services only to persons with whom it has a prior banking relationship, not to the general public. SIA Br. at 21-25, 28-30.<sup>7</sup> This reading, which

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<sup>7</sup> In arguing that banks may provide brokerage services only to pre-existing banking customers, SIA relies in part upon § 3(a)(4) of the Securities Exchange Act of 1934 (the "1934 Act") which defines "broker" to mean "any person engaged in the business of effecting transactions in securities for the account of others, but does not include a bank". SIA Br. at 21-22, citing 15 U.S.C. § 78c(a)(4) (1982). From the use of the term "others" in the 1934 Act, as opposed to "customers" in the Glass-Steagall Act, SIA concludes that the Glass-Steagall Congress intended to restrict bank brokerage activities to existing bank customers. As is clear from the language of the 1934 Act provision, however, Congress believed that banks *would* be covered under the 1934 Act as persons "engaged in the business of effecting transactions in securities for the account of others" *unless they were explicitly excluded*. Thus, to the extent that the 1934 Act is relevant, it actually shows that Congress thought banks performed exactly the same transactional function as ordinary brokers.

had been adopted by the Comptroller of the Currency in the early interpretations he has since rejected, *see* pp. 9-10, *supra*, gives the statutory language an emphasis and complexity of meaning that it simply does not have.

The purpose of the Glass-Steagall Act was to limit banks' ability to engage in underwriting. Given that purpose, the reference to purchases and sales "for the account of customers" obviously serves only to distinguish such agency transactions, which do not constitute underwriting or dealing and are permitted, from transactions made "for [the bank's] own account", which may constitute underwriting or dealing and are limited.<sup>8</sup> Neither the language of the statute nor the regulations promulgated thereunder require bank brokerage "customers" to be persons with a preexisting banking relationship with the particular bank.<sup>9</sup> A customer for bank brokerage services is no less a "customer" of the bank because he deals otherwise with other banks.

In addition, SIA's reading of the statute would raise a number of difficult definitional problems that Congress could be expected to have addressed if it had intended the term

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<sup>8</sup> *Cf. Broker/ Dealer Report, supra*, at xiv (distinguishing brokerage from dealing according to whether transaction is "for the account of the customer" or "for his [the dealer's] own account").

<sup>9</sup> Since well before the present controversy, in interpretations that remain unchanged, federal banking regulators have recognized that bank brokerage "customers" need not have any other relationship with the bank. The Office of the Comptroller of the Currency promulgated regulations in 1979 "applicable to recordkeeping and confirmation requirements for [securities] transactions" effected by national banks that define "customer" as:

"any person or account . . . for which a national bank effects or participates in effecting the purchase or sale of securities, but . . . [not] a broker, dealer, dealer bank or issuer of the securities which are subject to the transactions."

12 C.F.R. § 12.2(b) (1983). *See* 12 C.F.R. § 208.8(k)(1)(i) (1983) (same definition of "customer" promulgated in 1979 by Federal Reserve Board in relation to securities transactions effected by state member banks); 12 C.F.R. § 344.2(b) (1983) (same definition of "customer" promulgated in 1979 by Federal Deposit Insurance Corporation in relation to securities transactions effected by state nonmember banks); *see also* 44 Fed. Reg. 43,254-63 (1979).

"customers" to encompass only a limited class of persons having specific prior dealings with the bank. Presumably, if Congress had intended such a limitation, it would have specified the nature, duration and extent of the prior relationship required for an investor to be considered a bank "customer". Section 16 does not even suggest how these difficult definitional problems might be resolved, much less give any specific limitations. Absent some such indication of legislative intent to limit the scope of the term,<sup>10</sup> a bank "customer" for purposes of § 16 is simply an investor who comes to the bank for brokerage services.

This Court's decision in *Board of Governors of the Federal Reserve System v. Investment Company Institute*, *supra*, upholding a Board regulation that permitted bank holding companies and their nonbank subsidiaries to act as investment advisers to closed-end investment companies, further suggests that any user of bank brokerage services is a "customer" within the meaning of § 16. In ruling that the advisory relationship at issue in that case was permissible under § 16, the Court noted that "[w]hen an [investment] adviser makes a change in the securities portfolio of a closed-end company, the adviser is acting for the

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<sup>10</sup> The legislative history sheds little additional light on this issue. The Glass-Steagall Senate Report merely notes that under § 16 "banks are to be permitted to purchase and sell investment securities for their customers to the same extent as heretofore, but . . . for their own account only under such limitations and restriction as the Comptroller of the Currency may require." S. Rep. No. 77, 73d Cong., 1st Sess. 16 (1933). See also H.R. Rep. No. 150, 73d Cong., 1st Sess. 3 (1933). The legislative history of the Banking Act of 1935, which effected certain technical amendments to the Glass-Steagall Act, see n. 11 *infra*, noted only that its amendment of § 16 "ma[d]e it clear that . . . banks may purchase and sell stocks for the account of their customers but not for their own accounts". H.R. Rep. No. 742, 74th Cong., 1st Sess. 18 (1935). In each case, the emphasis is on distinguishing permissible agency transactions from impermissible transactions undertaken by a bank as principal, and in neither case is there the slightest evidence of any congressional attempt to limit the number of persons served (as opposed to the type of service provided), of any rationale for such a limitation, or of any guidelines for applying such a limitation.

account of its customer—not for its own account”. *Board of Governors of the Federal Reserve System v. Investment Company Institute*, *supra*, 450 U.S. at 66 n.37. Thus, this Court apparently viewed a closed-end company as a “customer” simply on the basis of its receipt of investment advice, without regard to whether other specific banking services were provided. The Court therefore seems to have recognized that the term “customer” as employed in § 16 does not require the extensive preexisting relationship that SIA espouses.

**B. The Legislative History Shows that Congress Intended To Permit Banks To Provide Brokerage Services.**

The legislative history of the Glass-Steagall Act expressly states that under § 16 “[n]ational banks are to be permitted to purchase and sell investment securities for their customers to the same extent as heretofore . . .”. S. Rep. No. 77, 73d Cong., 1st Sess. 16 (1933).<sup>11</sup> The intent of Congress, it would therefore appear, was to permit banks to continue their prior practices in the brokerage field.

Prior to the passage of the Glass-Steagall Act, the scope and nature of securities-related activities varied considerably among banks. *See, e.g.,* W. Peach, *The Security Affiliates of National Banks* 70-82 (1941). For that reason alone, it is difficult to suppose that Congress intended to limit banks’ brokerage activities to any particular format, much less to the

<sup>11</sup> As initially enacted, § 16 of the Glass-Steagall Act referred to “the business of dealing in investment securities” and had permitted national banks to purchase and sell “such securities” for customers’ accounts. Banking Act of 1933, Pub. L. No. 66, § 16, 48 Stat. 162, 184. The term “investment securities”, however, was defined elsewhere in the provision to include only debt securities. *Id.* Thus, the Glass-Steagall Act as initially enacted did not explicitly state that banks were authorized to purchase stocks—equity securities—for customers’ accounts. The Banking Act of 1935 amended § 16 to make it clear that national banks could “deal in” “securities and stock” for customers’ accounts, although not for their own accounts. *See* Banking Act of 1935, Pub. L. No. 305, § 308(a), (b), 49 Stat. 684, 709 (1935). As discussed above, *see* n. 10 *supra*, the legislative history of the 1935 statute sheds little additional light on the permissible extent of bank brokerage activities.

exceedingly narrow bounds petitioner espouses. So far as appears, banks generally did not require any particular form of prior banking relationship as a prerequisite for providing brokerage services, *see id.* at 28-31, 70-82, and in fact some banks offered such services to the general public. For example, one banking industry commentator writing in 1929 stated that banks "will, upon request, though some banks solicit this business, buy and sell securities for [their] customers *and the public in general.*" Smith, *Stock Market Service Comes High*, 21 Am. Bankers A. J. 965 (1929) (emphasis added); *see W. Peach, supra*, at 28-31, 70-82. Accordingly, in endorsing prior industry practice, the Glass-Steagall Congress contemplated that commercial banks would continue to provide brokerage services according to their own policies and without particular statutory limitation.

### C. Permitting Banks To Provide Brokerage Services Is Consistent with the Purposes of the Glass-Steagall Act.

As noted above, the overriding objective of the Glass-Steagall Act was to limit banks' authority to underwrite certain types of securities, *see* 12 U.S.C. §§ 24 (Seventh), 378 (1982), and to invest in certain securities for their own account, *see id.* § 24 (Seventh) (1982). The purpose of these restrictions was twofold. First, they had the fundamental economic objective of diminishing the commitment of commercial bank assets to long-term securities. Congress believed that the propensity to have bank assets "tied up" in such securities rendered banks illiquid and subjected them unduly to the risks inherent in such investments. *See, e.g.,* S. Rep. No. 77, 73d Cong., 1st Sess. 6-7, 8-10 (1933); 76 Cong. Rec. 1405 (1933) (remarks of Sen. Glass). *See also Board of Governors of the Federal Reserve System v. Investment Company Institute, supra*, 450 U.S. at 61-62. In addition, the Act has been interpreted as intended to protect commercial bank depositors from abuses possibly associated with the promotional role played by firms engaged in underwriting. In particular, it was the view of some that a commercial bank also acting as an investment banker might imprudently recommend the purchase of securities held or underwritten by it, or might make imprudent loans either to depositors for purposes of purchasing such securities or to the

issuers of the securities. *See generally Investment Company Institute v. Camp*, 401 U.S. 617, 630-34 (1971); U.S. Department of the Treasury, *Public Policy Aspects of Bank Securities Activities*, app. 18-21 (1975).

Brokerage activities do not involve these risks. First, because a commercial bank acting as a broker acts only as an agent for investors, its brokerage activities do not "tie up" bank capital or expose bank assets to the risks of the securities markets. Second, the promotional pressures which were thought to affect the judgment of a bank acting as an underwriter simply do not exist in the case of a bank acting as a broker. Such a bank does not take positions in particular securities for resale to investors, and all it has to promote is the price and quality of its brokerage service. It is fanciful to suggest that banks would give imprudent advice, make imprudent loans or engage in improper self-dealing for the sake of obtaining a slight marginal increase in brokerage commission income. *See New York Stock Exchange, Inc. v. Smith, supra*, 404 F. Supp. at 1099-1100 (banks purchasing and selling securities for the account of customers "do not have a salesman's interest in the securities' performances" and "are in competition with investment brokers only in terms of convenience, cost, and dependability"); *cf. Investment Company Institute v. Camp, supra*, 401 U.S. at 638 (promotional risks addressed by Act not present when bank purchases securities for customers' accounts). *See also* 12 U.S.C. § 1972(1) (1982) (prohibiting certain forms of tying and reciprocity in the furnishing of bank services).

## II

### THE GLASS-STEAGALL ACT DOES NOT FORBID COMMERCIAL BANK AFFILIATES TO CONDUCT A BROKERAGE BUSINESS.

Section 20 of the Glass-Steagall Act, 12 U.S.C. § 377 (1982), the only provision of the Act that bears directly on bank affiliates such as nonbank subsidiaries of a bank holding

company, see *Board of Governors of the Federal Reserve System v. Investment Company Institute*, *supra*, 450 U.S. at 58 n.24, limits the power of banks to affiliate with firms principally engaged in certain securities-related activities. Section 20 provides in pertinent part:

“[N]o member bank shall be affiliated . . . with any corporation . . . engaged principally in the issue, flotation, underwriting, public sale, or distribution at wholesale or retail or through syndicate participation of stocks, bonds, debentures, notes, or other securities.” 12 U.S.C. § 377 (1982).

SIA contends that brokerage activities constitute the “public sale” of securities within the meaning of § 20, so that a bank affiliate cannot lawfully offer such services. SIA Br. at 34-42. This contention is groundless.

First, it defies logic to argue that § 20 should forbid a bank affiliate to conduct a brokerage business when § 16 of the Act explicitly authorizes banks themselves to do so. SIA’s contention that §§ 16 and 20 of the Act are part of a “comprehensive structure governing banks’ direct and indirect participation in the prohibited activities” (SIA Br. at 35) completely misses the point. As § 16 demonstrates, the Act was *not* aimed at brokerage activities, but at other activities, especially underwriting. The limitations imposed on bank affiliates by § 20 cannot logically be more restrictive than those imposed on banks by § 16. Indeed, § 20 is intended to be more liberal in that it permits a bank affiliate to engage in activities forbidden to banks under § 16 unless the affiliate is “engaged principally” in such activities. See *Board of Governors of the Federal Reserve System v. Investment Company Institute*, *supra*, 450 U.S. at 64.

Second, it is clear from the statutory context that the phrase “public sale” refers only to the sale of securities as part of an underwriting and has nothing to do with brokerage “sales” occurring in the secondary markets. SIA does not dispute that the other activities referred to in § 20—“the issue, flotation, underwriting . . . [and] distribution” of secu-

rities—characterize the procedures involved in a public offering, the means by which large blocks of securities are transferred to the public through the underwriting process. Given this statutory context, the term “public sale” therefore naturally refers to a similar means of distributing securities to the public. *Cf. Jarecki v. G.D. Searle & Co.*, 367 U.S. 303, 307 (1961) (statutory term “gathers meaning from the words around it”).

Third, the term “public sale” cannot readily be understood to refer to the brokerage business. Brokers *sell* as agents for their customers, not for their own accounts, and they *buy* as well as sell on their customers’ behalf. The term “public sale” is therefore remarkably inapt as a description of the brokerage business. Particularly because § 20 refers to “*public sale*”, the statute is obviously aimed at the widespread public selling efforts which characterize an underwriting, not at the sort of transactions which individual buyers and sellers accomplish through their brokers. See Note, *A Banker’s Adventures in Brokerland: Looking Through Glass-Steagall at Discount Brokerage Services*, 81 Mich. L. Rev. 1498, 1498 n.2 & 1499 n.6 (1983). Congress knew perfectly well how to describe the brokerage business when it wished to do so, and it employed language well suited for that purpose in § 16, 12 U.S.C. § 24 (Seventh) (1982).

Finally, and by no means least important, the Board has long interpreted the term “public sale”, as employed in a parallel provision of the Glass-Steagall Act, to exclude brokerage activities. Section 32 of the Act prohibits certain managerial interlocks between commercial banks and firms “*primarily engaged in the issue, flotation, underwriting, public sale, or distribution*” of securities. 12 U.S.C. § 78 (1982) (emphasis added). The Board’s Regulation R, which implements this provision, expressly provides that “[a] broker who is engaged solely in executing orders for the purchase and sale of securities on behalf of others in the open market is not engaged in the business referred to in section 32”. 12 C.F.R. § 218.1 n.1 (1983). This regulation, which SIA has failed to address, was

promulgated in 1936 and codifies a Board ruling, 20 Fed. Res. Bull. 393 (1934), made not long after the Act was passed. Regulation R and the ruling it codifies compellingly demonstrate that the term "public sale" does not encompass brokerage activities. See *Board of Governors of the Federal Reserve System v. Agnew*, 329 U.S. 441, 445 & n. 3 (1947).

### III

#### **THE BANK HOLDING COMPANY ACT PERMITS A BANK HOLDING COMPANY TO ACQUIRE A BROKERAGE FIRM.**

Under § 4(c)(8) of the Bank Holding Company Act, 12 U.S.C. § 1843(c)(8) (1982), the provisions of that Act which restrict the power of bank holding companies to acquire shares of nonbanking corporations do not apply to:

"shares of any company the activities of which the Board after due notice and opportunity for hearing has determined (by order or regulation) to be so closely related to banking or managing or controlling banks as to be a proper incident thereto. . . . In determining whether a particular activity is a proper incident to banking or managing or controlling banks the Board shall consider whether its performance by an affiliate of a holding company can reasonably be expected to produce benefits to the public, such as greater convenience, increased competition, or gains in efficiency, that outweigh possible adverse effects, such as undue concentration of resources, decreased or unfair competition, conflicts of interests, or unsound banking practices." 12 U.S.C. § 1843(c)(8)(1982).

This provision is generally interpreted as requiring the Board to determine that (1) the activities of the acquired corporation are "closely related" to banking, and (2) the anticipated public benefits of the acquisition outweigh possible adverse effects.

*E.g., National Courier Association v. Board of Governors of the Federal Reserve System*, 516 F.2d 1229, 1232-33 (D.C. Cir. 1975).

SIA contends that the Court below erred in upholding the order of the Board approving BAC's application to acquire Schwab primarily because Schwab's brokerage activities are merely "similar" to banking activities and are not "closely related" thereto. SIA Br. at 12-19. Specifically, SIA contends that the Bank Holding Company Act permits bank affiliates only "to provide certain bank support activities". *Id.* at 13. In addition, it contends that in enacting certain amendments to the Act in 1970, Congress "refused" to adopt a "functionally related" test for determining which activities are permissible for bank affiliates. *Id.* at 14. As we show below, SIA's contentions misapprehend the pertinent statutory standards. Because banks are expressly authorized to engage in brokerage activities, such activities may lawfully be performed by bank affiliates as well.<sup>12</sup>

#### **A. Bank Affiliate Activities Are Not Limited to Support Services.**

The Bank Holding Company Act does not limit bank

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<sup>12</sup> SIA no longer presses its argument, made before the Court of Appeals, that the Board applied an incorrect legal standard in evaluating the public benefits of the acquisition. As noted above, § 4(c)(8) of the Bank Holding Company Act requires the Board to consider whether performance of particular activities by a bank holding company subsidiary "can reasonably be expected to produce benefits to the public . . . that outweigh possible adverse effects . . ." and permits the Board to differentiate between "activities commenced de novo and activities commenced by the acquisition . . . of a going concern". The Board found, and the Court of Appeals agreed, that BAC's acquisition of Schwab will create public benefits by increasing competition, convenience and efficiency. *BankAmerica Corp. (Schwab)*, 69 Fed. Res. Bull. 105, 109-10 (1983).

affiliates to providing certain support services for banking operations. Were bank affiliate activities so limited, then they could not provide the wide array of services—including credit card operations, factoring, leasing, and real estate appraisal—which they are now authorized to perform. See 12 C.F.R. § 225.4 (1983), *to be recodified at* 12 C.F.R. § 225.25, *see* 49 Fed. Reg. 794 & 818 (1984). Congress' intent in restricting the activities that may be conducted by bank affiliates was not to confine bank affiliates to the same activities as banks, but "to divorce the bank holding companies from their *industrial empires*", 102 Cong. Rec. 6755 (1956) (emphasis added), and to prevent bank holding companies from acquiring "centralized control [of] an *unlimited number and variety of businesses*". H.R. Rep. No. 609, 84th Cong., 1st Sess. 4 (1955) (emphasis added).<sup>13</sup> A bank holding company's acquisition of a financial services firm—particularly one performing services lawfully performed by banks—is hardly the sort of conglomeration the Act was designed to prevent.

Moreover, SIA's arguments to the contrary notwithstanding, the intent of Congress in amending § 4(c)(8) of the Act in 1970 is, as this Court has observed, "difficult to discern". *Board of Governors of the Federal Reserve System v. Investment Company Institute*, *supra*, 450 U.S. at 73. Certainly SIA errs in asserting that Congress "refused" to adopt a "functionally related" standard (SIA Br. at 14, 16), when Senator Sparkman, a member of the Conference Committee responsible for the language of the amendment, commented that the wording ultimately adopted "differs only slightly in language and *none in substance*" from the "functionally related" language originally proposed by the Board. 116 Cong. Rec. 42,432 (1970)

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<sup>13</sup> The kind of bank holding company diversification to be prevented by the Act was exemplified by one bank holding company that either owned or controlled not only several banks, but also industrial firms engaged in:

"oil and gas, fish canning and processing, frozen foods, castings, forge equipment, kitchen tools, and agricultural equipment." H.R. Rep. No. 609, 84th Cong., 1st Sess. 4 (1955).

(emphasis added).<sup>14</sup> Courts have in fact consistently held that bank holding company subsidiaries may perform services that are "operationally or functionally similar" to banking services. See *National Courier Association v. Board of Governors of the Federal Reserve System*, *supra*, 516 F.2d at 1237; *Alabama Association of Insurance Agents v. Board of Governors of the Federal Reserve System*, 533 F.2d 224, 241 (5th Cir. 1976), *vacated in part*, 558 F.2d 729 (5th Cir. 1977), *cert. denied*, 435 U.S. 904 (1978); *Association of Bank Travel Bureaus, Inc. v. Board of Governors of the Federal Reserve System*, 568 F.2d 549, 551 (7th Cir. 1978); *NCNB Corp. v. Board of Governors of the Federal Reserve System*, 599 F.2d 609, 613 (4th Cir. 1979).

In any event, as we show below, the provision of discount brokerage service is "closely related" to banking within the meaning of the statute as it has been consistently interpreted by Federal banking regulators and by the lower Federal courts.

#### **B. Brokerage Activities Are "Closely Related" to Banking.**

As discussed above, Section 16 of the Glass-Steagall Act expressly authorizes commercial banks to conduct a brokerage business. See pp. 3-17, *supra*. Because Congress has included the power to buy and sell securities for the account of customers among the powers of banks, it is indisputable that these brokerage activities are "so closely related to banking . . . as to be a proper incident thereto". 12 U.S.C. § 1843(c)(8) (1982). In this respect, operation of a brokerage business by a bank holding company is similar to the operation of any other

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<sup>14</sup> The legislative history of the 1970 amendment is recapitulated by this Court in *Board of Governors of the Federal Reserve System v. Investment Company Institute*, *supra*, 450 U.S. at 72-78. Originally, the Board had urged adoption of a "functionally related" test to determine the propriety of bank affiliates' activities. Language incorporating this test was passed by both Houses of Congress, but was dropped by the Conference Committee in the final version of the bill. The Conference Committee Report, which was signed by only four of seven House conference managers, indicated that Congress had not adopted the more liberal standard. The Report was later criticized as "an inaccurate indication of the conference's intent". See *id.*, 450 U.S. at 73-75 & n.54.

business that has been found, by statute or regulation, to be "incidental . . . [to] the business of banking", 12 U.S.C. § 24 (Seventh) (1983), or "closely related to banking", 12 C.F.R. § 225.4, *supra*.<sup>15</sup> We submit that the explicit statutory authority is conclusive on the "closely related" issue.

Even if this authority were not conclusive, however, SIA's contentions would not justify overturning the Board's determination under the "closely related" standard. In *National Courier Association v. Board of Governors of the Federal Reserve System*, *supra*, a leading decision in which the District of Columbia Circuit construed the "closely related" standard of § 4(c)(8), the Court that:

"at least the following seem to us within the statutory intent:

"1. Banks generally have in fact provided the proposed services.

"2. Banks generally provide services that are operationally or functionally so similar to the proposed services as to equip them particularly well to provide the proposed service.

"3. Banks generally provide services that are so integrally related to the proposed services as to require their provision in a specialized form." 516 F.2d at 1237.

Of these three criteria, which are posed in the alternative and are not exhaustive, *see id.*, both the first and the second undoubtedly apply to the brokerage activities at issue here. As shown above, banks have long performed all the functions of a securities broker, including direct execution of securities transactions. *See pp. 3-8, supra*. Moreover, as the Board determined as a result of its exhaustive inquiry on the present application, many banks routinely offer various securities ser-

<sup>15</sup> Such activities include, but are not limited to, credit card and factoring operations, loan servicing, investment and financial advising, leasing of personal property, financial, banking or economic data processing, financial courier services, financial management consulting, and real estate appraisal. *See* 12 C.F.R. § 225.4, *supra*.

vices, particularly in connection with their management of trust and custodial accounts, which closely parallel those of an ordinary brokerage business. *BankAmerica Corp. (Schwab)*, *supra*, 69 Fed. Res. Bull. at 107-08. In short, SIA's contentions cannot obscure the fact that the buying and selling of securities on an agency basis has been a common banking practice throughout this century, *see Board of Governors of the Federal Reserve System v. Investment Company Institute*, *supra*, 450 U.S. at 55; *see also* pp. 3-8, *supra*, and is therefore "so closely related to banking . . . as to be a proper incident thereto" within the meaning of § 4(c)(8).

### CONCLUSION

For the reasons stated above, the judgment of the Court of Appeals should be affirmed.

Respectfully submitted,

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